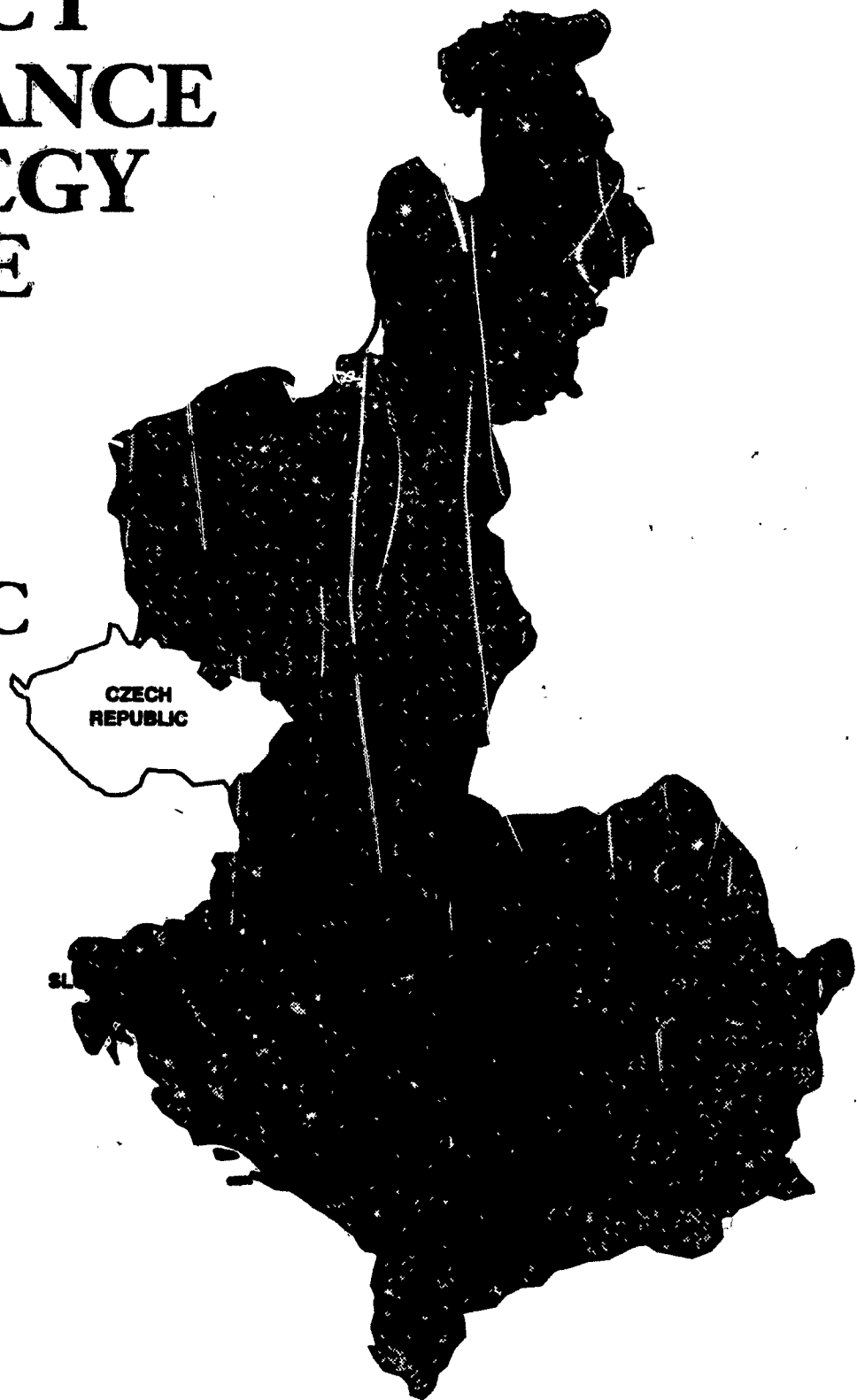


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# **UNITED STATES SEED ACT ASSISTANCE STRATEGY UPDATE**

**FOR  
CZECH  
REPUBLIC**



**1994-1996**

**Submitted by American Embassy Warsaw  
Approved July 19, 1994**

# U.S. ASSISTANCE STRATEGY FOR THE CZECH REPUBLIC

(REVISED MARCH 1994)

## I. STATUS OF REFORMS

In 1993 the Czech Republic successfully maintained its determined and steady course towards a fully democratic and market-based economy. Its stability is even more extraordinary when compared to apparent reform fatigue occurring in neighboring transition countries. The Czech Republic's economic, political and social development over the past 12 months further confirms the wisdom and appropriateness of rapidly moving to a U.S.- Czech relationship that is a genuine partnership between fully-functioning democracies.

### *ECONOMIC REFORM*

Czech economic reform continued apace. Decline in GDP bottomed out and the economy is expected to grow moderately in 1994. A competitive exchange rate helped to rapidly shift trade from 80 percent going to CMEA countries in 1989 to 70 percent toward OECD countries by 1993. Most of the major macroeconomic indicators are positive, including a balance of payments surplus, a balanced budget, healthy foreign reserves and relatively low inflation (less than 10% in the first two months of 1994). The Czech government's conservative fiscal and monetary policy helped maintain a core inflation rate of under one percent monthly, although the 1993 rate was about 20 percent due to the introduction of a new tax system. The 1994 inflation rate is likely to be about ten percent. Unemployment is expected to be in the range of five to seven percent by the end of 1994, with regional variations from near one percent in Prague to near 10% in hardest hit areas.

Economic transformation continued with the completion of the "First Wave" of privatization and start of a "Second Wave". The coupon privatization program, with seven million Czechs participating, combined with over \$4 billion in all forms of foreign investment, has made the rapid Czech privatization effort a resounding success. Over 2,000 firms were privatized during the "First Wave."

The pace of market reforms decelerated in 1993, but that was partly because many reforms had already been made, with some of the tougher ones -- privatization of the largest state-owned

enterprises, post-privatization restructuring, financial market reforms -- remaining. The "Second Wave", now underway and covering some 1,200 firms, is one example. It will effectively conclude the privatization process, but there remain three main challenges that must be addressed to ensure continued investor confidence. The "Second Wave" includes some of the largest and most complex companies, which will require substantial restructuring to escape bankruptcy. Successful restructuring will not only provide a positive signal for investors, it also will lead to targeting production for export, further bolstering Czech trade. Another challenge will be to establish appropriate controls and regulatory systems for the privatized sector to guarantee that investors, foreign and domestic, comply with their commitments and that firms provide timely and accurate information to investors. A third issue will be corporate governance and the need to change the behavior and attitudes of the newly privatized companies. Laws regarding conflict of interest and a system to control money laundering are needed. None of these issues in themselves threatens to halt the transformation, but they could slow it down if not tackled soon.

The financial sector matured further in 1993, with capital market resources climbing steadily. Sky-rocketing share prices on the Prague Stock Exchange in 1993 mirror the natural tendencies of an emerging capital market. Mutual funds grew with about one-half of the privatization coupons now managed by the funds. Four cities issued municipal bonds or had commercial banks issue them on their behalf. Moody's investment services gave the Czech Republic a BAAA rating (minimum grade suitable for institutional investors) and the city of Prague the higher rating of BBB.

The banking system has developed vigorously, with 55 licensed banks, including three state banks which have been privatized. Capable and energetic bank management has contributed to the continued progress. Issues remain, however, particularly bankruptcies and questionable quality of bank assets. The country assistance strategy's cautionary note last year on the potential for widespread bankruptcies is less necessary as the banks have sought creative approaches to resolving this problem. While some 1,000 bankruptcy cases are backlogged in the courts, they largely represent small-scale businesses, whose liquidation do not threaten a bank's survival. Bankruptcies of the large firms or a bailout by the Czech Government are being avoided through financial restructuring, including such techniques as debt-equity swaps, and generous work-out periods provided by the banks. Czech banks recognize that large-scale bankruptcies are not in their interest. By reaching international standards of capital adequacy, Czech banks will be better positioned to absorb loan losses and to attract foreign capital.

The financial sector's growth has outpaced regulation, which led to the first two major banking scandals in early 1994. Based on

this experience and a growing understanding of the need to better manage the currently chaotic market, the Czech Government is now tightening up considerably on banking supervision and loan guidelines used by the banks.

The economic transformation has succeeded in part because the **labor force** has also successfully adjusted. By the end of 1992, 25% of the five million-strong labor force had effectively changed jobs. According to Czech government sources, one million had passed through the Czech government's regional employment offices for retraining or job placement. Contrary to the strategy's note that labor immobility might cause pockets of high unemployment, Czechs have been willing to commute long distances to new jobs, keeping their existing housing. Long-distance commuting is viable because of the highly subsidized transport system. Labor's flexibility may be tested in the next few years. but so far Czech workers have shown an admirable ability to adapt to new conditions.

The rapidly expanding **small business sector** has absorbed a large portion of the labor force. The Czech government's regional entrepreneur centers are beginning their role of providing effective technical counsel to small businesses. The challenge will be to channel sufficient and affordable capital to the sector to maintain its growth.

#### **IMPROVING THE QUALITY OF LIFE**

Progress in improving the **quality of life** has been less dramatic, but steady. This is consistent with the Czech government's policy of putting economic reform before social reform. Therefore, social policy reforms have been given less attention. The structure of a not-for-profit sector, for example, has been debated for more than a year, delaying the transformation of areas in which not-for-profits could make a difference, such as the health sector. Key policies and laws, however, are expected to be enacted in 1994 in the energy, environment, and not-for-profit sectors. For example, Parliament in March approved the long-awaited Housing Law, which allows for private ownership of apartments. The lengthy process itself -- the researching of all alternatives, the public debate -- will, with luck, result in policies more suited to the Czech public sphere and therefore more effective than might have been the case with a faster approach.

While numerous policies are still awaited, progress has been made in establishing the base for improving life for the Czech people. The Ministry of Health has a strategy that aims to complete privatization of the **health sector** within two years. Some 20,000 doctors have already established private practices. In the **environment sector**, systems are now monitoring air quality in the most polluted regions, providing local government officials

pollution data on which they can base their decisions of whether to restrict industrial output and city traffic. There is also an improved capability in the ministries as well as regions to conduct project environmental impact assessments and to determine investment priorities. Rapid improvement, however, has been hindered by a lack of affordable capital. The municipal financing system is one avenue expected to address this issue. The challenge will be to develop projects with sufficient return on investment.

### ***SUPPORTING DEMOCRATIC INSTITUTIONS***

The basic institutions necessary for a healthy democracy have been established. The Czechs held free and fair multiparty elections, have a functioning central government, legislature, and judiciary, and enjoy access to diverse opinions in the media. The challenge is to ensure that these and other democratic institutions work in the context of a public sphere acknowledged to be legitimate and fair by Czech citizens. Development of public confidence in democratic institutions, such as the national parliament, is needed, as well as developing the citizens' belief that they can and must participate in the decision-making as a privilege and duty to ensure that those institutions function well. This attitudinal change will only occur over an extended period of time.

It is post's belief that assistance in the area of democratic institution building can and must proceed on the premise that we are working with partners, not clients. To this end, the Embassy Democracy Commission will oversee projects intended to enhance the growth of mutually held **democratic attitudes** within existing institutions rather than the wholesale construction of institutions themselves.

Overall, the successful economic transformation in the Czech Republic has made it easier for the country to establish fully functioning democratic institutions. Privatization has led to diversification of economic power, creating a middle class and institutions of civil society that are the foundation of Western democracies. The central government's decentralization policy has given municipalities increased authority. The Czech Republic is becoming solidly rooted in democratic and free-market principles. The success of communal and Senate elections in 1994 and the Parliamentary elections scheduled for 1996 will be important milestones for the Czech Republic's democratic evolution.

Other challenges will be to jump-start broad **educational reform** - both curricula and administration - and to increase journalistic responsibility and professionalism. Again, lack of capital is a major obstacle. No adequately developed advertising base exists to keep media outlets in Czech hands without government subsidy.

## II. PROGRAM ASSESSMENT

Program implementation continues to proceed effectively in the four priority areas given in last year's strategy. Many programs are on course to achieving their objectives, but are not yet at a stage where their full impact can be quantitatively measured.

### **PRIORITY ONE: SUPPORTING ECONOMIC TRANSFORMATION**

Completing the major portions of the privatization program and establishing the basic infrastructure needed for the financial sector and capital markets continues to be the top priority of U.S. assistance and of the Czech Government.

#### **• HELPING PRIVATIZATION WORK**

Assisting the Czech Ministry of Privatization negotiate large privatizations involving foreign investment continued, completing "First Wave" projects and beginning work on "Second Wave" projects. U.S.-funded volunteer programs provided effective personnel, particularly legal advisors. By creating a fair and transparent investment environment, U.S. assistance helped American investors become more competitive, claiming about one-third of all foreign investment in the Czech Republic. Privatization assistance began to give more attention to post-privatization activities at the National Property Fund and assisting the Ministry of Industry and Trade with financial restructuring for some 20 complex "Second Wave" firms.

#### **• DEVELOPING THE FINANCIAL SECTOR**

*Developing Capital Markets:* In the Prague Stock Exchange's first year, share prices of the few blue chip stocks soared, but trading was thin. Select stocks attracted considerable foreign investment due to the country's economic and political stability. Trading, however, has been chaotic, raising the potential for fraud. Czechs have been slow in recognizing the system's vulnerability, resulting in only a recent request for assistance.

*Strengthening the Banking System:* As anticipated, U.S. assistance to the **Czech Savings Bank** shifted in 1993 from the bank's management and operations to more focus on the bank's mutual fund, the largest such fund in the country. The **Komerční Bank's** long-term advisor completed his tasks having helped the bank deal with international audits, restructuring of its balance sheet and negotiating with such international lenders as the European Bank for Reconstruction and Development (EBRD). **Komerční Bank** showed significant profit in 1993 and is reaching international standards of capital adequacy. The **Czech Banking Training Institute** developed a plan to become self-sustainable within a few years. The **Czechoslovak Trade Bank** privatization

was delayed due to major bad debts incurred in pre-1989 deals with neighboring countries. Assistance will begin in 1994.

The **Housing Guaranty** program, through its associated technical assistance provided to several cities, made significant changes how these cities will approach commercial banks for long-term financing. Similar advice to other cities and commercial banks is expected to make further changes in loan terms and conditions.

*Dealing with Bankruptcy:* While U.S. advisors helped amend the bankruptcy law, the impact of bankruptcy was reduced by Czech efforts to avoid widespread bankruptcies through financial restructuring of larger firms. Training programs in corporate governance and commercial law have been designed for 1994.

#### **PRIORITY TWO: BROADENING PARTICIPATION**

This priority targets the regional and local level, helping to address key issues, strengthen municipalities' administrative and financial capabilities, support small and medium sized business development, and create an informed citizenry.

*Local government support:* In 1993, program design efforts for the Housing Guaranty Program and its associated technical assistance were undertaken, selecting cities and commercial banks with which the program will work. IESC and Peace Corps volunteers continued to provide technical advice to cities, with particular emphasis on increased public participation in the decision-making process.

*Small and medium size business:* The Czech American Enterprise Fund continued to seek equity investment opportunities or provide loans to small entrepreneurs having invested \$7.6 million in 19 Czech enterprises as of 1993. Peace Corps and IESC volunteers worked in regional business centers to advise entrepreneurs on developing financial and business plans. The Czechoslovak Management Center also provided training in this area.

#### **PRIORITY THREE: ENERGY AND ENVIRONMENT**

Fostering development of efficient energy production and use, which concurrently improves the environment, continued.

##### **• ENERGY**

U.S. assistance helped prepare an energy law which will create a regulatory framework for the electric power and gas industries. Seminars and training were provided to key government and utility officials on economic regulation of utilities and the structure and management of independent regulatory authorities. Department of Energy programs in three Czech cities developed cost-effective

strategies for reducing energy waste and improving the environment. A new project began in the Northern Bohemian city of Usti nad Labem. Efforts to promote energy service companies (ESCOs) also began in 1993. Nuclear operational safety was a third area of training and technical assistance in 1993, including a regulatory safety review of the fuel and instrumentation and control systems at the Temelin nuclear power plant, systems being supplied by Westinghouse and representing the first major effort to combine U.S. and Russian systems.

#### • ENVIRONMENT

The Environmental Protection Agency (EPA) completed risk analysis for the northern Moravia region of Ostrava, which indicated that coke oven emissions are the most serious environmental risk in the region. Follow-up work, to develop strategies for modernization of steel production began in 1993. Training in environmental policy, risk assessment, business management, public outreach, environmental management, economics and finance, were among the courses offered to government, non-government and private sector representatives. A demonstration waste minimization project in the largest petrochemical plant in the Czech Republic was completed and highly publicized.

#### **PRIORITY FOUR: FURTHERING EDUCATIONAL, LEGAL AND MEDIA REFORM**

To further bolster media, legal and educational institutions essential to broadening public participation in economic and political reform, a wide array of programs continued in the last year. More than 125 Czechs traveled to the U.S. under these programs in 1993. Media training in the country continued as well the establishment of a radio education facility.

Assistance through the United States Information Service (USIS) included technical support and training for emerging journalists' associations concerned with their trade's professionalism and ethics, and for journalism and communications studies faculties.

The American Bar Association CEELI Project has continued to assist the Ministry of Justice and Czech Judge's Association with topics including a new judicial code, expanded availability of legal information, and recodification of the criminal code.

USIS sent judges and parliamentarians to the U.S. for a perspective on how comparable problems are addressed. Furthermore, many other aspects of the USIS International Visitors Program, such as journalists' orientation and special public health trips, kept the spotlight on the need to implement effective legislation. Repeated Worldnet television conferences, such as that on money laundering or not-for-profit organization, served the same end.



### **III. REVISED ASSISTANCE STRATEGY**

The decision last year to begin phase-down of assistance to the Czech Republic in 1994 has been validated by the country's continued progress in economic, political and social reform. The revised strategy accelerates the previous phase-down strategy. By the end of Fiscal Year (FY) 1995, funding will be reduced to half that of FY 1992. The strategy does not imply a total phase-out in FY 1995. Only a very few high priority assistance efforts should continue, while a distinct phase-down of a large number of activities occurs. By the end of FY 1997, the programs will be narrowed to:

- Housing Guaranty Program and associated technical assistance, including public administration,
- Participant Training,
- Peace Corps,
- EPA's transborder Project Silesia,
- Management Training and economic education, and
- USIS programs in educational reform and media training.

Phase-out will be completed by the end of FY 1998. Modest funding, however, should be considered to continue USIS efforts in media training and education reform.

A rapid phase-out is fully consistent with the Czech Government's views. In December 1993, Prime Minister Klaus declared that only post-transition reforms remained to be accomplished. On March 17 both the Minister of Industry and Trade, and Minister of Economy publicly endorsed the phase-out as an "appreciation of the (country's) positive economic development."

A premature cut-off of funds, however, would damage the sustainability and ultimate success of some of the U.S.'s most important achievements. The Czech Republic's success sets a notable precedent for the Central and Eastern European region and serves as a beacon for the Newly Independent States (NIS) that the painful transformation can produce rewards. For the U.S. strategy to succeed, resources necessary to complete the programs planned must be maintained. Further efforts to build permanent bridges between the two countries also will help achieve the long-term U.S. foreign policy objectives in the region.

#### **PRIORITY ONE: SUPPORTING ECONOMIC TRANSFORMATION**

This will continue to be the top priority.

##### **• HELPING PRIVATIZATION WORK**

The Advisory Team working with the Ministry of Privatization is helping negotiate some 100 "Second Wave" projects, with 20 to 40

more projects expected. Continued assistance will be needed until the "Second Wave" is completed, which is now estimated to be by mid-1995. Assistance will support post-privatization activities at the National Property Fund and assist the Ministry of Industry and Trade with financial restructuring of some of the most difficult "Second Wave" companies. U.S. assistance will:

- Review, negotiate and complete "Second Wave" privatization;
- Supervise tenders;
- Assist the National Property Fund in developing a post-privatization monitoring system;
- Provide the National Property Fund with legal advice pertaining to investors who do not meet their obligations, and
- Assist the Czech government in the analysis of financial restructuring programs submitted by local and foreign investors or banks.

The various U.S. volunteer programs will continue to provide a reduced number of business and legal advisors through FY 1995, with the exception of Peace Corps volunteers furnished through the Small Business program which will continue through FY 1998.

- **HELPING TRANSFORM THE HEALTH SECTOR**

U.S. assistance has focused on creating a viable not-for-profit sector, insurance plan and quality assurance. In each case, the assistance aims to make the health sector more economical and responsive to the health needs. Technical assistance and training will be provided through FY 1996 to select health institutions planning to become not-for-profit institutions. Introduction of quality assurance programs and hospital accreditation will also begin in 1994 with U.S. assistance.

- **HELPING CREATE A MANAGEMENT CADRE**

Management training, a critical underpinning of the economic transformation, has been provided under several programs. The two most successful are the Czechoslovak Management Center and the Center for Economic Research and Graduate Education (CERGE). Both have become leading institutions in providing new managers and economic researchers to the expanding Czech (and regional) private sector. U.S. support will be narrowly focused on these programs, continuing until 1998 to assure their sustainability.

- **DEVELOPING THE FINANCIAL SECTOR**

*Developing Capital Markets:* AID, the Financial Services Volunteer Corps and the Securities and Exchange Commission are working with Czech officials to identify specific problems and resources to address them. Short-term technical assistance and

training will begin in FY 1994 and end no later than FY 1996.

**Strengthening the Banking System:** U.S. assistance to the **Czech Savings Bank** through mid-FY 1994, will focus on management and operations of securities processing and foreign payments. Short-term technical banking assistance as well as training is expected to continue to various banking institutions into FY 1995. The **Foreign Trade Bank** maintains its dominant position in foreign exchange and trade finance. Like other major banks in the Czech Republic, it wants to become a universal banking institution. Long- and short-term assistance will begin in 1994 focused on strengthening the credit function and improving the bank's project and corporate finance capabilities.

Commercial banks have little experience in municipal finance, but will take an increasing role as municipalities assume more responsibility for their own capital improvements. A central aim of the technical assistance associated with the **Housing Guaranty** program will be to assist commercial banks in such areas as project appraisal, credit analysis and financial reporting. Commercial banks will play a central role in the municipal finance system, which will be initially capitalized with \$20 million provided in 1994 by the Housing Guaranty agreement.

**Encouraging Corporate Governance:** While the issue of bankruptcy appears to be diminished by the government's efforts to restructure the larger firms, corporate governance issues in newly-privatized companies need attention. In 1994, training and technical assistance will be provided.

#### **PRIORITY TWO: HELPING LOCAL GOVERNMENTS BECOME RESPONSIVE**

U.S. assistance targets the local level, helping address key issues, strengthen municipal administrative and financial capabilities, and promote governmental responsiveness to the public will. The Housing Guaranty Program (HG) and its associated technical assistance are the central activities aimed at this priority objective. Additional cities will be selected from those that have expressed initial interest in the program to be provided intensive assistance. The still-to-be-established Public Administration contract will provide further support, as will other projects in the energy and environment portfolio which are working with individual cities. The Peace Corps will continue to provide long-term municipal advisors through 1998.

#### **PRIORITY THREE: FURTHER SOLIDIFY DEMOCRATIC INSTITUTIONS**

Assistance will focus less on creating democratic institutions and more on strengthening democratic behavior of existing institutions. Assistance will encourage public participation in the process, and governmental response to public will.

One area of concentration will be reform of civic education. Previous efforts have provided U.S. training to Czech educators. Continued support will help develop new curricula, increase the numbers of teachers and teacher trainers with civics training, and create appropriate teaching materials. Continuing efforts will be made to help reform educational administration, to put the new curricula and new or re-trained teachers into classrooms.

In the journalism field, assistance will continue with journalism and communications faculties (Charles University), new press associations (in Brno and Prague), the Students Press Association (Prague), the Center for Independent Journalism, and perhaps even the training facility that may emerge concomitant with Radio Free Europe's relocation to Prague. This will develop professionalism and a dedication to responsible journalism. Links will be made between Czech and U.S. faculties for continuing joint projects in the role of media in a civic society.

The attached Democracy Strategy gives more detail on this topic.

#### ***PRIORITY FOUR: ENCOURAGE ENERGY EFFICIENCY & IMPROVED ENVIRONMENT***

Fostering development of efficient energy production and use, which concurrently improves the environment, will continue into 1996, with more emphasis on establishing policy frameworks, helping develop viable projects for financing, and building on the experiences gained in demonstration projects as well as previous training. The coordinated overlap of energy and environment programs will help focus the limited U.S. assistance resources on results-oriented activities.

- **ENERGY:** The utilities partnerships with the Czech Power Company and Prague Distribution Company are expected to benefit both partners as well as other energy institutions well beyond the U.S. assisted program, which will end in 1996. U.S. regulatory assistance will also continue in that timeframe working with the electric power and gas industries. Department of Energy programs to develop cost-effective strategies for reducing energy waste and improving the environment will phase down with the final project in the city of Usti nad Labem. Nuclear regulatory and operational safety training and technical assistance currently planned to continue into 1996, may be extended into 1997.

- **ENVIRONMENT:** Most of the training programs will be completed in 1995, shifting emphasis toward financing issues related to the environment sector. EPA's transborder Project Silesia will proceed into 1997, supporting to identify means to address the priority problems. The technical assistance provided under the Environmental Action Plan will be targeted at specific municipal or industrial projects that hold greatest promise of improving the country's environmental health. Emphasis will again be on

transferring skills and technology to Czech institutions in order to assure sustainability of the U.S. investment.

### **SPECIAL ISSUES**

**Democracy Network:** The Mission is in full support of a two-year program for the Czech Republic within the framework of the attached Democracy Strategy.

**Social Sector Restructuring:** U.S. assistance to the Czech Republic has been based on the overall priorities of government leadership and individual activities have been demand-driven since 1991. The Czech government consistently asked donors to give priority to assisting the economic transformation, particularly privatization. Social safety net programs have generally not been a priority for the Czech Government except in the restructuring of health services. U.S. assistance provided to the Ministry of Health has been in a number of different technical areas, including exposure to the U.S. system of health insurance reimbursements based on diagnostic groups, quality assurance and actuarial assistance. To support transformation in the health sector as requested by the Minister of Finance, the U.S. has provided advice on developing a not-for-profit sector, without advocating one particular approach.

In addition to transformation in the health sector, the U.S. assistance program has included activities that strengthen Czechs' abilities to address social issues. Examples include the public participation efforts under various environment programs, or the behavioral changes promoted through the Partnerships in Health program. The Democracy Network program will provide an additional resource to address social sector issues.

**Regional Integration:** Becoming a member of the European Union is the top foreign policy objective of the Czech Republic. However, as stated by the Minister of Industry and Trade recently, political integration is a two-way street where the western countries also must attempt some political, even economic, reforms rather than expecting them all from post-Communist countries. The Minister particularly cited western Europe's welfare-state policies and protection of inefficient industries as areas in need of reform. The Czech Republic meets three of the five criteria for EU membership as detailed in the Maastricht Treaty. As for economic integration, the Czech Republic has advanced rapidly in shifting its trade to the West.

**Regional Infrastructure:** The Czech Republic has moved forward to improve its transportation infrastructure. Plans for upgrading routes to Germany are in place with EBRD and Czech government financing. A major rail line is also slated for EBRD financing, along with EU/PHARE and Czech funds. While not a critical issue for the Czech Republic, infrastructure development is getting

appropriate attention. U.S. assistance should be only indirect,  
via the EBRD.

Additional information contact:

American Embassy Prague  
Office of the A.I.D. Representative  
Trziste 15-11801 Praha  
APO AE 09213

Office: 0-11-42-2-2451-0758  
FAX: 0-11-42-2-2451-0340 or 41

Agency for International Development  
320 21st Street, N.W.  
Czech Desk, ENI/ECA/WT, Room 6754 NS  
Washington D.C. 20523-0069

Office: (202)647-6091  
FAX: (202)647-5560

APPR: CP ( )

DRAFT: PA ( )

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AID/ENI/ECA:MMAMLOUK (DRAFT)      AID/ENI/ECA/NT:BHOWARD (DRAFT)  
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PRIORITY PRAGUE

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TAGS:

SUBJECT: RESULTS OF REVIEW OF U.S. ASSISTANCE STRATEGY  
FOR THE CZECH REPUBLIC

THIS IS A JOINT STATE/AID CABLE

1. SUMMARY: THE DRAFT U.S. ASSISTANCE STRATEGY UPDATE DOCUMENT FOR THE CZECH REPUBLIC WAS REVIEWED DURING AN INTER-AGENCY MEETING ON MAY 13, 1994. THE DECISIONS AND GENERAL PROGRAM CONCLUSIONS FROM THE REVIEW ARE SUMMARIZED BELOW. DURING THE STRATEGY DISCUSSION, IT WAS AGREED THAT FY 1996 WOULD BE THE LAST YEAR FOR OBLIGATIONS UNDER THE CZECH PROGRAM. THE MISSION WAS REQUESTED TO DEVELOP A SCHEDULE FOR PROGRAM PHASE OUT TO ENSURE THAT ACTIVITIES ARE COMPLETED BY FY97, WITH KEY DECISION POINTS IDENTIFIED ON ISSUES THAT COULD AFFECT THE COURSE AND PACE OF IMPLEMENTATION. THE STRATEGY REVIEW REAFFIRMED THE COUNTRY'S TEAM VIEW THAT THE BASIC FRAMEWORK FOR ECONOMIC AND DEMOCRATIC REFORM IS NOW SUCCESSFULLY AND FIRMLY IN PLACE AND IS IRREVERSIBLE. END SUMMARY.

2. INTER-AGENCY REVIEW: THE INTER-AGENCY MEETING, CHAIRED BY DAA/ENI CARLOS PASCUAL, WAS ATTENDED BY AIDREP/PRAGUE LEE ROUSSEL WITH REPRESENTATIVES FROM NSC, EUR AND D/EEA FROM STATE, TREASURY, OMB, USAID/ENI, USIA, DOJ AND FTC WAS HELD ON MAY 13. THE AIDREP AND THE COUNTRY TEAM WERE COMMENDED FOR HAVING DEVELOPED A

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FOCUSSED AND WELL THOUGHT OUT STRATEGY DOCUMENT. THE FOLLOWING IS A RECORD OF DISCUSSION FOR THIS MEETING.

I. PRIORITY 1: SUPPORT OF ECONOMIC TRANSFORMATION

3. THE CZECH AND SLOVAK AMERICAN ENTERPRISE FUND (CSAEF) AND POST-PRIVATIZATION PROGRAMMING: LIMITED RESOURCES REMAIN AVAILABLE TO THE CZECH & SLOVAK AMERICAN ENTERPRISE FUND (UNDER DOLS 20 MILLION) AND THE FUND EXPECTS TO PLACE LESS THAN 20 NEW INVESTMENTS FOR BOTH REPUBLICS OVER THE NEXT TWELVE MONTHS. IT WAS GENERALLY AGREED THAT THE FINANCIAL SITUATION OF THE CSAEF WILL DRIVE THE FUND'S DECISION FOR FUTURE ACTIVITIES. IT WILL BE NECESSARY TO DEVELOP A CLEAR POST-PRIVATIZATION STRATEGY WHICH TREASURY WILL BE DEFINING IN THE UPCOMING MONTH. THERE WAS CONCERN VOICED OVER THE ABILITY OF THE CZECH FINANCIAL SYSTEM TO SURVIVE A MAJOR COLLAPSE BUT THERE WAS CONSENSUS THAT THE BASIC MACRO-ECONOMIC FRAMEWORK WAS STRONG. IT WAS AGREED THAT ASSISTANCE WILL BE NEEDED IN FY 1995 AND FY 1996 TO HELP SUSTAIN THE WORK DONE IN AREAS THAT HAVE NOT YET SOLIDIFIED (I.E CONTRACTUAL COMPLIANCE AND BANKING).

4. THE POST HAD REQUESTED SUPPORT FOR THE CZECH MANAGEMENT CENTER (CMC) WHICH PROVIDES MANAGEMENT TRAINING AND THE CENTER FOR ECONOMIC RESEARCH AND GRADUATE EDUCATION (CERGE) WHICH PROVIDES PH.D. EDUCATION TO STUDENTS FROM THROUGHOUT THE REGION. THESE TWO INSTITUTIONS, ORIGINALLY SET UP AS NEW INSTITUTIONS INDEPENDENT OF THE OLD COMMUNIST UNIVERSITY STRUCTURE, HAVE RECEIVED ACADEMIC RECOGNITION AND ARE NOW WELL RECOGNIZED AS TWO OF THE BEST RESULTS OF AID SUPPORT IN THE REGION. WHILE SEED FINANCING REMAINS (AFTER TUITION) CMC'S MAJOR SOURCE OF REVENUE, IT HAS ALSO RECEIVED FINANCING FROM A LARGE NUMBER OF PRIVATE DONORS AND FOREIGN GOVERNMENTS. CERGE HAS NOW FORGED A PARTNERSHIP WITH CHARLES UNIVERSITY IN PRAGUE AND THE ECONOMICS INSTITUTE AND SERVES AS THE GOVERNMENT'S THINK TANK ON ECONOMIC POLICY ISSUES. BOTH INSTITUTIONS HAVE CREDIBLE PLANS FOR SUSTAINABILITY WITHIN FOUR TO FIVE YEARS. IT WAS DECIDED THAT APPLICANTS FOR NEW GRANTS FOR THE CZECH REPUBLIC AS A COUNTRY PARTICIPATING IN THE RFP FOR MANAGEMENT TRAINING WOULD BE ADVISED THAT FUNDING WILL NOT BE CONSIDERED, AND IN TURN WE WILL CONSIDER AN UNSOLICITED PROPOSAL FROM CMC-CERGE TO CONTINUE THE WORK THEY HAVE BEEN DOING SO WELL.

II. PRIORITY 2 : HELPING LOCAL GOVERNMENTS BECOME RESPONSIVE

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5. DECENTRALIZATION IS NATIONAL CZECH POLICY AND THE DONORS WERE ASKED LAST YEAR TO GIVE SPECIAL ATTENTION TO THE NEEDS OF AREAS OUTSIDE PRAGUE. IMPLEMENTATION OF THE NEW TAX LAW PROVIDES SIGNIFICANT RESOURCES TO LOCAL GOVERNMENT. HOWEVER, THE INEXPERIENCED LOCAL GOVERNMENT STRUCTURE IS CLEARLY NOT UP TO THE EXPECTATIONS WHICH HAVE BEEN CREATED. THE STRATEGY REVIEW AFFIRMED THAT STRENGTHENING LOCAL GOVERNMENT IS APPROPRIATELY HIGH PRIORITY DURING THIS PHASE OUT PERIOD.

6. PUBLIC ADMINISTRATION REGIONAL PROGRAM: THE NEW REQUEST FOR PROPOSALS (RFP) FOR PUBLIC ADMINISTRATION WORK HAS RECENTLY BEEN RELEASED AND WILL HAVE A REGIONAL COMPONENT WHICH WILL INCLUDE ACTIVITIES IN THE CZECH REPUBLIC. THE ADVANTAGE OF A REGIONAL CONTRACTING STRUCTURE FOR THE PUBLIC ADMINISTRATION PROGRAM WILL BE THE ABILITY TO ASSESS THE NEEDS AND GO STEP BY STEP TO BEST DEFINE THE APPROACH OF TECHNICAL ASSISTANCE IN THIS AREA. THERE IS A HIGH DEGREE OF COMPLIMENTARITY BETWEEN THE TECHNICAL ASSISTANCE BEING PROVIDED THROUGH THE HOUSING AND MUNICIPAL DEVELOPMENT PROJECT IN CONJUNCTION WITH THE HOUSING GUARANTY LOAN PROGRAM AND THE KINDS OF ACTIVITIES EXPECTED TO BE PROVIDED THROUGH THE PUBLIC ADMINISTRATION PROGRAM. STAFF FROM ENI/EEUD AND ENI/DG, IN COLLABORATION WITH OAR/PRAGUE, WILL WORK TOGETHER AS THE PUBLIC ADMINISTRATION REGIONAL GRANT IS REVIEWED TO ENSURE THAT THE TWO PROGRAMS ARE MUTUALLY REINFORCING.

7. HOUSING GUARANTY LOAN: ON MAY 16, AN IMPLEMENTATION AGREEMENT WAS SIGNED ON THE HOUSING GUARANTY (HG) LOAN PROGRAM FOR THE DEVELOPMENT OF A MUNICIPAL INFRASTRUCTURE FINANCE SYSTEM. THIS PROGRAM ENVISIONS A LONG TERM COMMITMENT OF UP TO DOLS 100 MILLION FOR HOUSING RELATED INFRASTRUCTURE LOAN GUARANTEES. THE PROGRAM HAS BEEN VERY VISIBLE IN THE CZECH REPUBLIC AND WE HAVE MADE A VERY PUBLIC COMMITMENT TO CONTINUE THIS WORK. THE COMMERCIAL BANKS HAVE BEEN AGGRESSIVE IN THEIR PLANS FOR LENDING. CZECH MUNICIPALITIES HAVE ALSO VOICED STRONG SUPPORT FOR THE PROGRAM AND ARE ACTIVELY PREPARING POTENTIAL PROJECTS FOR FINANCING THROUGH THE HG RESOURCES. ALTHOUGH THE FULL DOLS 100 MILLION IN GUARANTEES MAY NOT BE NEEDED, WE MUST MAKE PLANS WITH USAID'S OFFICE OF ENVIRONMENT AND URBAN PROGRAMS (G/ENV/UD), IN COLLABORATION WITH OAR/PRAGUE, TO PROGRAM THE DOLS 80 MILLION IN HG LOAN AUTHORITY REMAINING TO BE AUTHORIZED. IN ADDITION TO THE HOUSING GUARANTY LOAN, THE SEED BUDGET WILL CONTINUE TO FINANCE TECHNICAL ASSISTANCE TO THE COMMERCIAL BANKS IN PROJECT EVALUATION AND UNDERWRITING AND TO LOCAL GOVERNMENTS IN SOUND CAPITAL DEVELOPMENT PLANNING AND PROJECT DEVELOPMENT METHODS. SOME ADDITIONAL ASSISTANCE AT THE NATIONAL LEVEL WILL BE

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GIVEN TO THE CZECH MORAVIAN DEVELOPMENT BANK WHICH IS MANAGING THE MUNICIPAL INFRASTRUCTURE FINANCE FUND. WHILE WE SHOULD TARGET TECHNICAL ASSISTANCE ACTIVITIES TO BE COMPLETED IN FY97, IT WAS RECOGNIZED THAT, DEPENDING ON DEMAND FOR LOAN FINANCING UNDER THE HOUSING GUARANTY, IMPLEMENTATION OF SOME ACTIVITIES MAY NEED TO EXTEND BEYOND FY 1997, POTENTIALLY SUPERVISED FROM THE REGIONAL SUPPORT OFFICE IN POLAND. THE MISSION'S PHASE-OUT PLAN SHOULD SET A DATE TO ASSESS THE STATUS OF PROGRAM IMPLEMENTATION AND IDENTIFY KEY ISSUES THAT WILL AFFECT OUR DECISIONS ON ON-GOING IMPLEMENTATION.

8. CONCERN WAS RAISED ABOUT THE SPEED OF IMPLEMENTING THESE LOCAL GOVERNMENT PROGRAMS AND THE ABILITY WE HAVE TO MOBILIZE PEOPLE QUICKLY. THE POTENTIAL FOR LASTING IMPACT IN THIS AREA IS GREAT AND POST AND USAID/W SHOULD WORK TOGETHER TO MOVE THE PROCESS ALONG.

### III. PRIORITY 3: FURTHER SOLIDIFY DEMOCRATIC INSTITUTIONS

9. EDUCATIONAL REFORM IS AN AREA WHERE USIA CONTINUES TO WORK, PRIMARILY AT THE SECONDARY SCHOOL LEVEL THROUGH THEIR CIVIC EDUCATION PROGRAM. THEY HAVE WORKED WITH CONTINUING EDUCATION AT THE TERTIARY LEVEL THROUGH ESTABLISHED FULLBRIGHT SCHOLARSHIP PROGRAMS. RELATIVE TO THE LIMITED AMOUNT OF TIME REMAINING IN THE COUNTRY PROGRAM, IT WAS QUESTIONED WHETHER THE LEVEL OF EFFORT WAS SUFFICIENT ENOUGH TO HAVE AN IMPACT OVER THE NEXT TWO YEARS. IT WAS SUGGESTED THAT USIS LEVERAGE THE USE OF OUTSIDE GROUPS IN THESE AREAS TO MAKE MORE OF AN IMPACT ON THEIR OWN PROGRAMS.

10. IN THE AREA OF MEDIA REFORM AND THE INTERNATIONAL MEDIA FUND, THE SELF-SUSTAINABILITY AND INCREASED FUNDING FOR THEIR PRINCIPAL OUTLET, THE CENTER FOR INDEPENDENT JOURNALISM, WAS DISCUSSED. THE PRIMARY INTEREST OF THE COUNTRY TEAM IS TO HELP MAINTAIN A PLURALISTIC MEDIA. AIDREP ROUSSEL SAID THAT THE MEDIA IS STILL NOT AGGRESSIVE AND IS PROFESSIONALLY WEAK AND THEREFORE IN NEED OF OUTSIDE ASSISTANCE FOR TRAINING. MEDIA TRAINING WILL CONTINUE TO BE A PRIORITY IN THE COUNTRY TEAM'S INTEREST IN PROMOTING A FREE AND INDEPENDENT MEDIA.

11. IT WAS ALSO RECOMMENDED THAT IF USIS BELIEVES THERE ARE PROGRAMS THAT MERIT LONGER-TERM USG INVOLVEMENT, THAT IT SHOULD BEGIN TO IDENTIFY ITS OWN RESOURCES FROM ITS TRADITIONAL PROGRAMS TO CONTINUE ASSISTANCE.

12. THE DEMOCRACY NETWORK PROGRAM WAS ANNOUNCED IN JANUARY DURING PRESIDENT CLINTON'S TRIP TO PRAGUE. THE

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COUNTRY TEAM SUPPORTED THE PROGRAM WITH A CABLE OUTLINING SPECIFIC CRITERIA TO BE ADDRESSED IN THE PROGRAM TO BUILD THE FOUNDATION FOR A CIVIL SOCIETY AND AN ACTIVE NON-PROFIT SECTOR. THE EMPHASIS WILL BE PLACED ON TRAINING AND TECHNICAL CONSULTATIONS WITH MOST OF THE SUB-GRANTS BEING PROVIDED TO CZECH UMBRELLA ORGANIZATIONS TO PERMIT THEM TO EXPAND THEIR EFFORTS TO PROVIDE TRAINING AND SUPPORT TO THIS SECTOR. ASSURANCE WAS GIVEN TO THE COUNTRY TEAM THAT THE CZECH PARTICIPATION IN THIS PROGRAM WOULD BEGIN IN FY 1994 AND IT WOULD BE ON A FAST TRACK. THE GRANT SHOULD BEGIN IN FY 1994 AND THE PROGRAM WILL LAST TWO YEARS FOR A TOTAL OF DOLS 1.25 MILLION IN THE AREAS SPECIFIED BY THE COUNTRY TEAM.

#### IV. PRIORITY 4: ENCOURAGE ENERGY EFFICIENCY AND IMPROVED ENVIRONMENT

13. THE ENVIRONMENTAL ACTION PLAN (EAP) BEGAN ITS EFFORT TO IDENTIFY INVESTMENTS THIS YEAR. THE EAP'S GOAL IS TO IMPROVE THE ENVIRONMENTAL HEALTH OF CZECH COMMUNITIES AND IN THIS REGARD, SEVERAL ENVIRONMENTAL PROJECTS, BOTH MUNICIPAL AND INDUSTRIAL HAVE BEEN IDENTIFIED. FOLLOW-UP MISSIONS TO PROVIDE SPECIFIC TECHNICAL ASSISTANCE TO THESE PROJECTS WILL BEGIN THIS SUMMER. THE PROGRAM IS PROJECTED TO INCREASE IN 1995 AS MORE PROJECTS ARE IDENTIFIED AND TECHNICAL ASSISTANCE PROVIDED. THE TECHNICAL ASSISTANCE PROVIDED UNDER THE EAP IS DESIGNED TO DEVELOP ENVIRONMENTAL PROJECTS TO THE "BANKABLE" STAGE. IT WAS AGREED THAT THE EAP EFFORT SHOULD EMPHASIZE DEVELOPING ENVIRONMENTAL HEALTH PROJECTS THAT WOULD QUALIFY FOR THE HOUSING GUARANTEE. STAFF PRESENT FROM BOTH ENI/ENR AND ENI/UDH AGREED TO COLLABORATE ON PROJECTS AND ACTIVITIES TO ENSURE THAT THE PROGRAMS ACT TO COMPLIMENT EACH OTHER.

#### V. CONCLUSION

14. THE NEED FOR PROJECT CONSOLIDATION AND A TIGHTER FOCUS FOR OUT-YEAR PROGRAMS WILL BE THE MAIN ISSUE AS THE USAID PROGRAM BEGINS TO PHASE-DOWN. BOTH AN ADMINISTRATIVE AND A PROGRAM ASSESSMENT WILL BE NEEDED TO LOOK AT ISSUES SUCH AS BENCHMARKS, EVALUATION CRITERIA, LEGAL IMPLICATIONS, STAFFING AND MONITORING NEEDS AS THE PROGRAMS CLOSE-OUT. IN AN EFFORT TO BEGIN THIS PROCESS FOR THE EXPECTED FINAL YEAR OF FUNDING IN FY 1996, DAA/ENI CARLOS PASCUAL WILL TRAVEL TO PRAGUE IN JULY TO BEGIN WORKING ON AN OUTLINE FOR CLOSE-OUT. THE TEAM WORKING ON THESE ISSUES WILL REVIEW THE BENCHMARKS FOR MONITORING AND EVALUATING FINAL YEAR PROGRAMS AND, AT THE REQUEST OF OMB, A CHART WILL BE DRAWN UP TO REPRESENT THE FINAL MONTH OF ACTIVITY FOR EACH PROGRAM. AFTER THE PROGRAM TEAM HAS

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DEFINED AN IMPLEMENTATION PLAN FOR PHASING OUT, THE TECHNICAL AND ADMINISTRATIVE STEPS REQUIRED IN CLOSING DOWN THE OFFICE OF THE AIDREP WILL BE REVIEWED AND PLANNED.

15. RATHER THAN SPEND ADDITIONAL TIME EDITING THE COUNTRY STRATEGY TO INCORPORATE THE ABOVE COMMENTS, THIS CABLE WILL BE ADDED AS A PREFACE TO THE COUNTRY STRATEGY WHEN IT IS REPRODUCED. ANY NECESSARY CHANGES IN THE BUDGET, HOWEVER, SHOULD BE MADE PRIOR TO REPRODUCING THE STRATEGY

16. THIS CABLE HAS BEEN CLEARED BY THE FOLLOWING INTER-AGENCIES: COMMERCE (MMOWERY), OPIC (TREADWELL), TREASURY (SALTHERM), EXIM (MCCAULEY), AND USIA (APORTNOY)  
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